Simon Center for Regional Forecasting
2014 Conference

The Financial Outlook for American Families

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The Financial Outlook for American Families

- The Center for Household Financial Stability
- Household income trends
- Demographic drivers of household wealth levels and trends
- Who has recovered their wealth losses from the Great Recession?
- The financial outlook for American families

Center for Household Financial Stability

- **A research and policy initiative of the Federal Reserve Bank of St. Louis: www.stlouisfed.org/hfs.**

- **Our research and policy goals**
  - **What is the state of American families' balance sheets?**
  - **How do households' balance-sheet conditions affect communities and the broader economy?**
  - **What can we do to enhance the stability of household balance sheets and the economy?**

Center for Household Financial Stability

- **A research and policy initiative of the Federal Reserve Bank of St. Louis: www.stlouisfed.org/hfs.**

- **Some of our specific research questions:**
  - **Which families suffered the most during the financial crisis?**
  - **Why are only some families recovering from the crisis?**
  - **What household balance-sheet characteristics are associated with financial instability?**

What is Household Financial Stability?

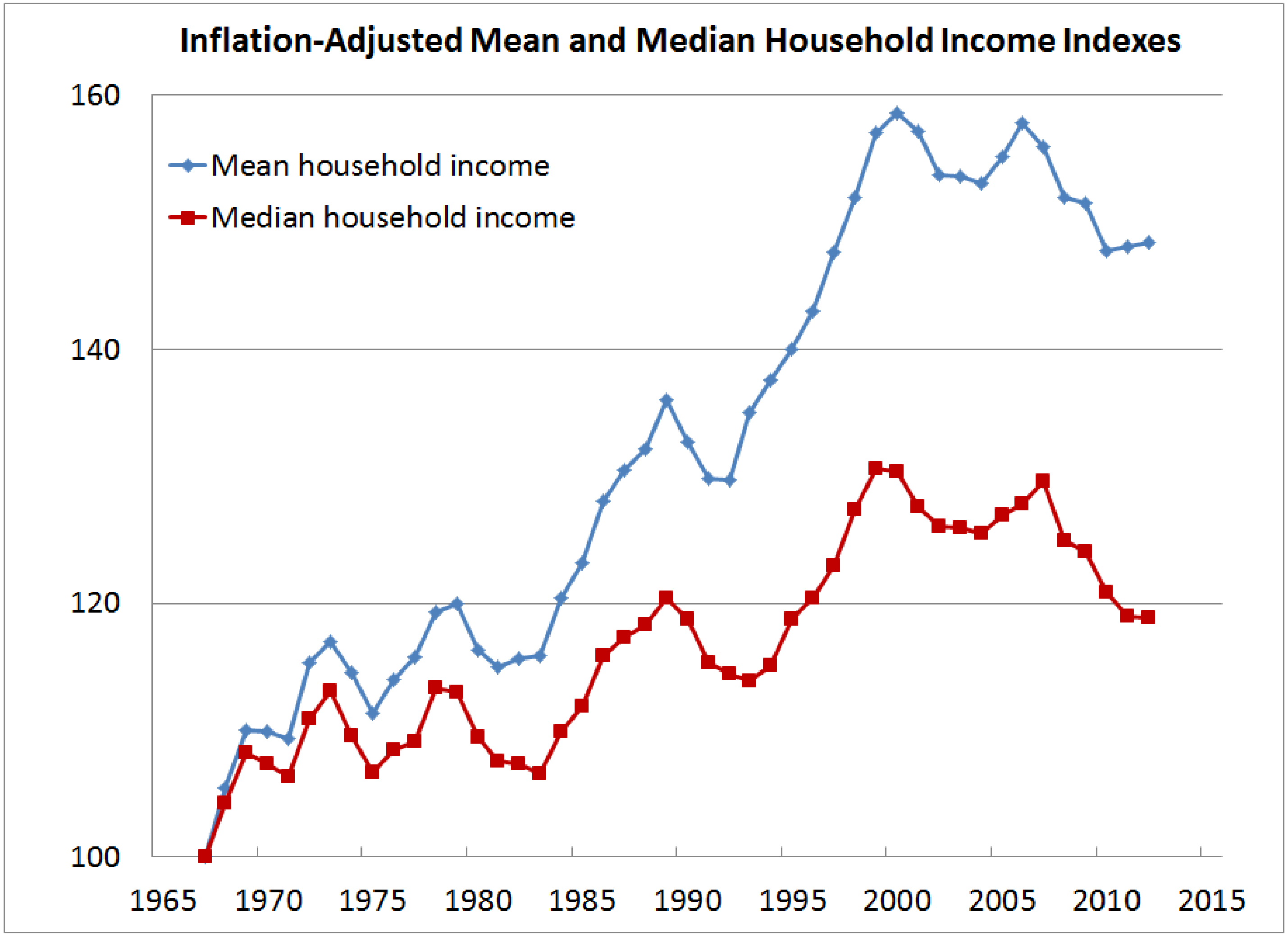
- **A household is "financially stable" when it can:**
  - **Meet its ordinary and ongoing financial obligations without resorting to forced sales of assets or wealth-depleting financial services.**
  - **Achieve its reasonable long-term financial goals, such as homeownership, children's education, and retirement.**
  - **Rebound relatively quickly from economic, financial, or other shocks.**

What is Household Financial Instability?

- **Household financial *instability* is reflected in:**
  - **Personal bankruptcy, mortgage foreclosure, or other debt default.**
  - **Inability to access credit on reasonable terms or at all.**
  - **Distressed sale of a home, car, or other major asset.**
  - **Failure to achieve a long-term financial goal.**
  - **Inability to recover from an economic or financial shock.**

Median Household Income Even Weaker than Mean Income => Increasing Inequality

Index levels equal 100 in 1967

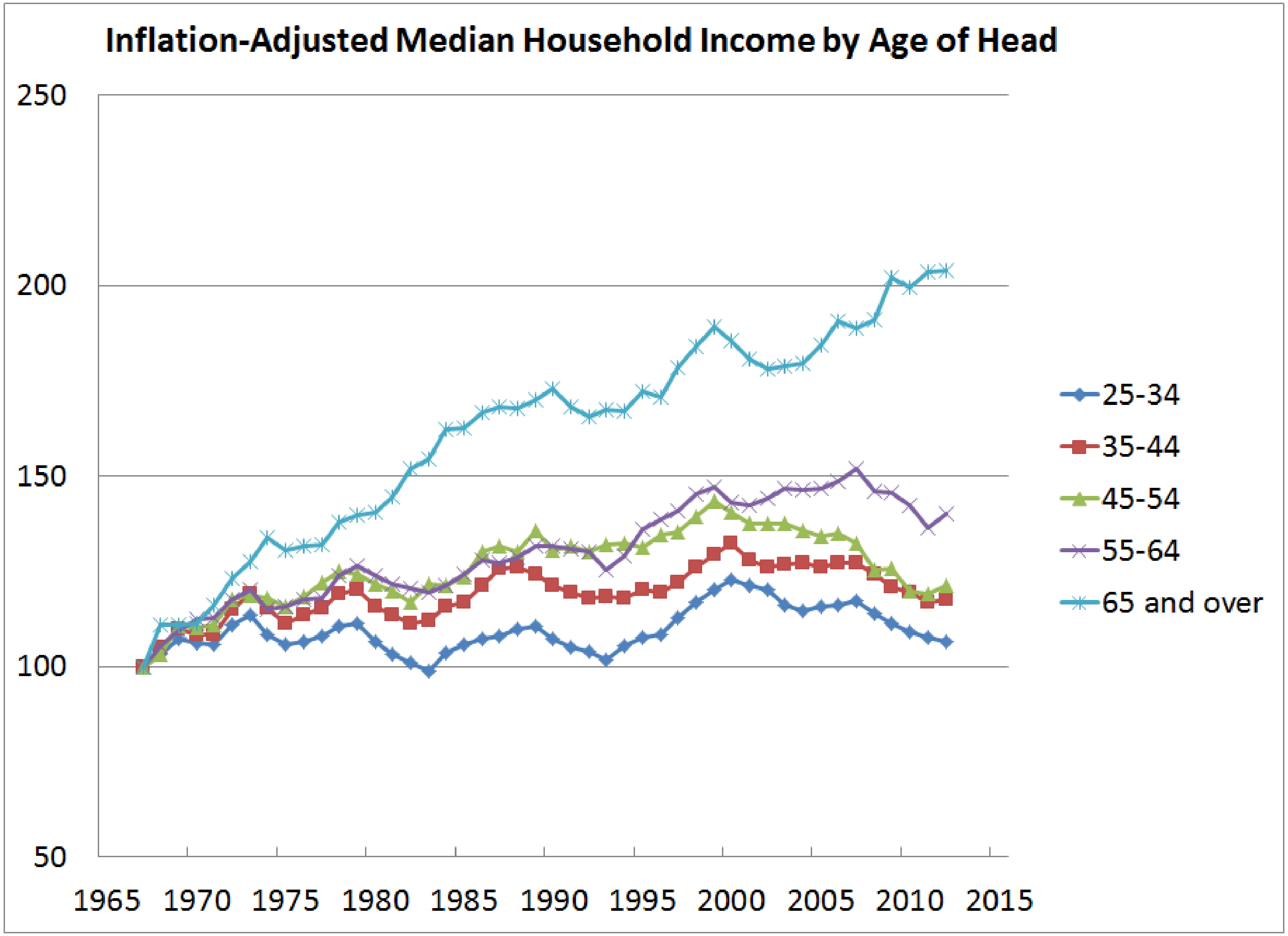


Source: Census Bureau

Annual through 2012

Older Families' Income Sources Are Not Very Sensitive to Labor Market

Index levels equal 100 in 1967

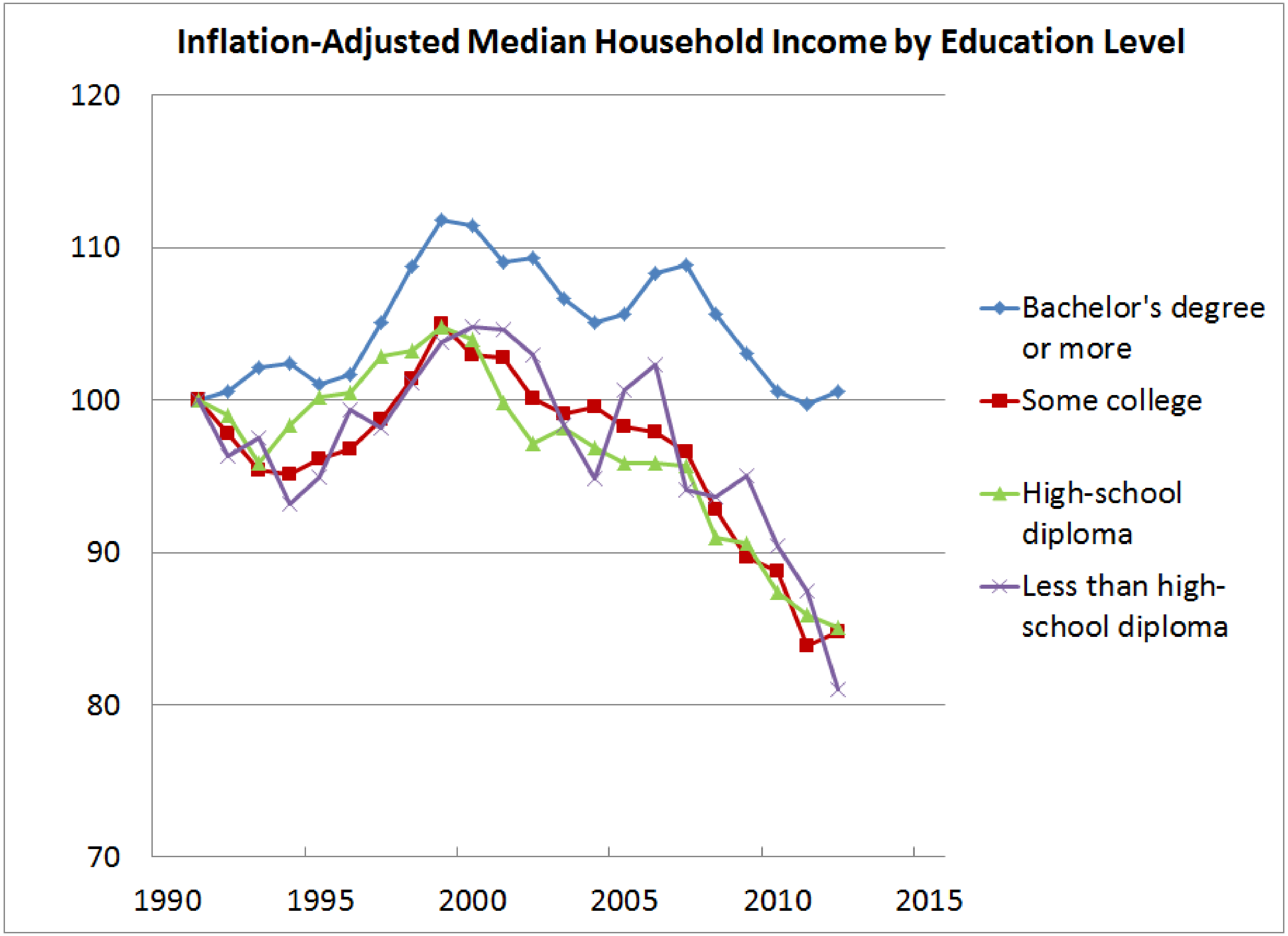


Source: Census Bureau

Annual through 2012

College Wage Premium Increasing Because Non-College Incomes Plunging

Index levels equal 100 in 1991



Source: Census Bureau

Annual through 2012

Best Explanation for Falling Real Incomes After 2000: IT Boom...

- **The Information-Technology (IT) boom accelerated in the 1980s and 1990s, raising demand for college-educated (cognitively skilled) workers**
  - **College-educated wages and the wage premium increased**
  - **Large corporate investments in IT**
  - **Related organizational changes, such as creation of IT departments, naming of Chief Information Officers, etc.**
  - **Increasing productivity growth for the economy overall**

IT Boom Passed Its Peak After 2000

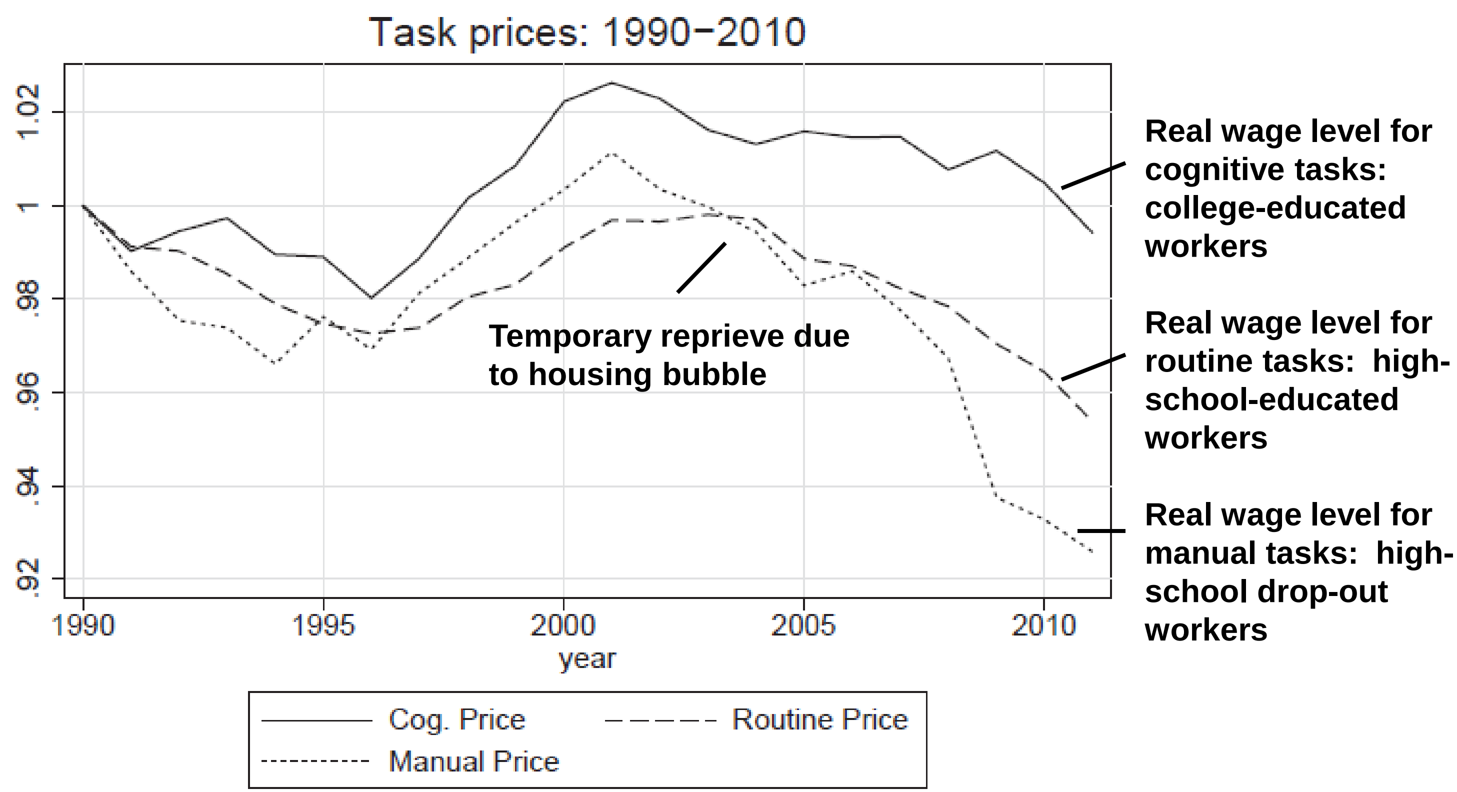
- **The IT boom reached a peak around 2000**
  - **Physical infrastructure (PCs, Internet, etc.) largely built out by 2000**
  - **Organizational changes (IT depts.) in place**
  - **Large cumulative increase in supply of educated workers, both in the U.S. and overseas (skilled out-sourcing)**

Waning of the IT Boom Affected Everyone

- **Results:**
  - **College wages generally falling after 2000**
  - **Lower-skill wages falling even faster, increasing the college wage premium**
  - **"De-skilling" in the labor market: College grads working in non-college jobs**
  - **"Cascading" effects on lower-skilled workers**
  - **Lowest-skilled workers exit the labor market**
  - **Stock-market crash after 2000 reflected lower growth expectations**

Falling College Wage Reflects “De-Skilling“, Forcing Lowest-Skilled Workers Out of Market

Figure 29:

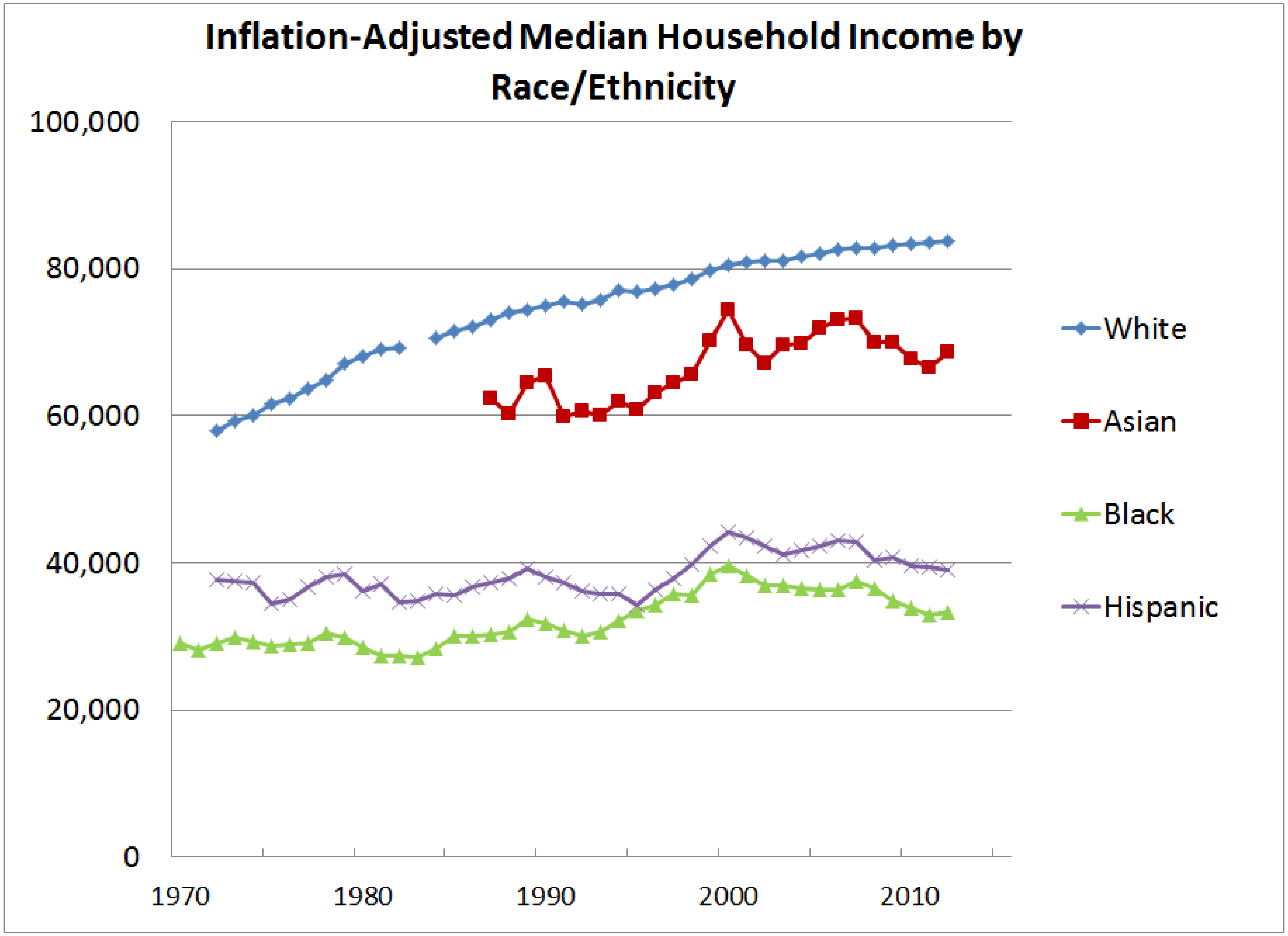


notes: The figure plots the task-price indices for manual, routine and cogntive tasks over time. The construction of the price indices is described in the text.

Source: Paul Beaudry, David A. Green, and Benjamin M. Sand, “The Great Reversal in the Demand for Skill and Cognitive Tasks,” University of British Columbia working paper, Mar. 2013.

White and Asian Median Incomes Remain Twice That of Blacks and Hispanics

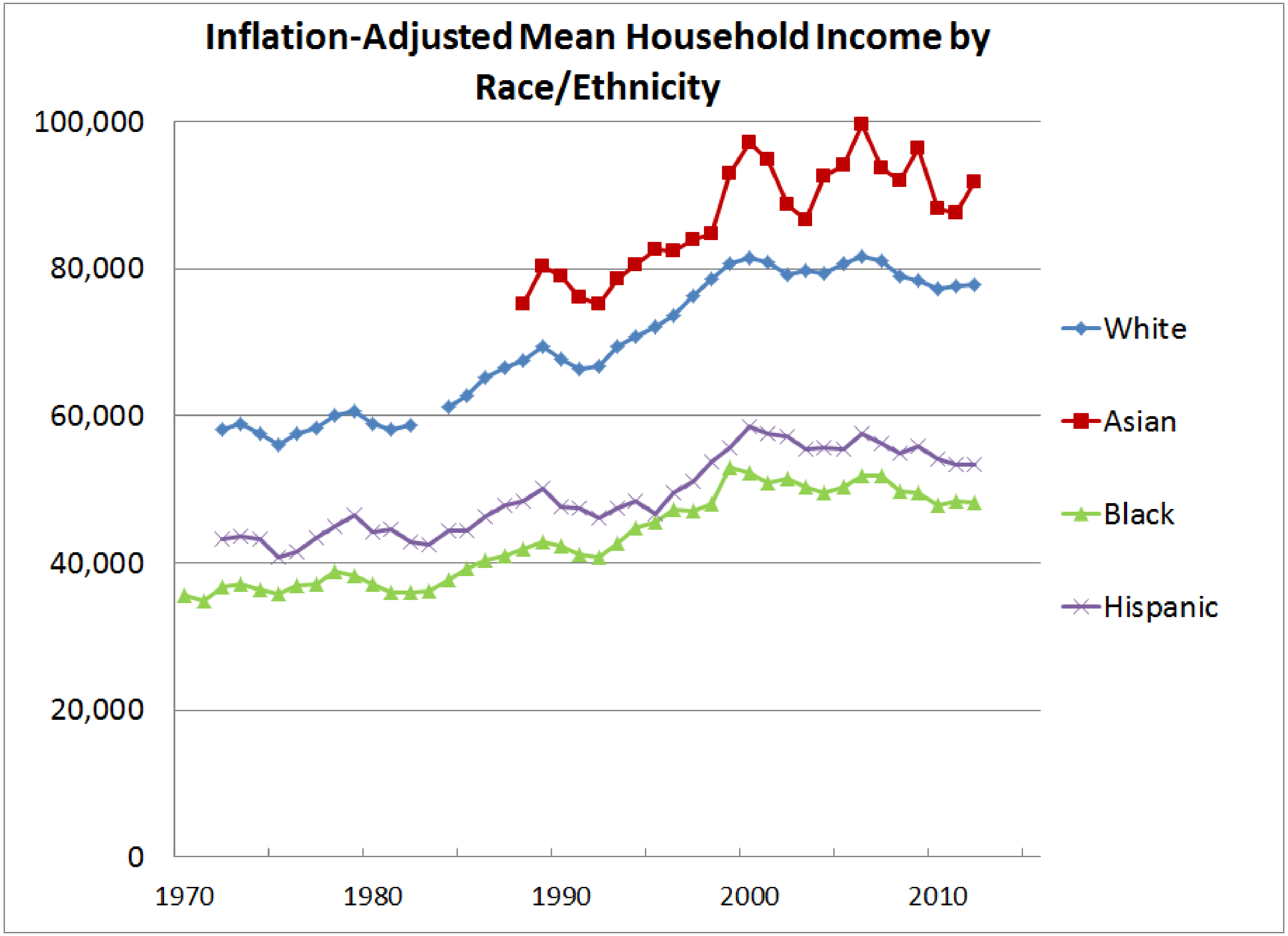
2012 CPI-U-RS adjusted dollars



Source: Census Bureau **Annual through 2012**

Mean Asian Incomes are Higher than Any Other Group

2012 CPI-U-RS adjusted dollars



Source: Census Bureau

Annual through 2012

Conclusions from Household Income Trends

- **For the population as a whole**
  - **Mean income grew faster than median income from the mid-1960s until 2000, indicating growing inequality.**
  - **Both mean and median household incomes have fallen since 2000.**
- **Across age groups**
  - **Older households (55+) have relatively low incomes but they have grown faster than incomes of those under 55 because their income sources are less sensitive to the labor market.**
  - **Median incomes of young and middle-aged households have fallen sharply since 2000.**

Conclusions from Household Income Trends

- **Across levels of educational attainment**
  - **Median incomes have fallen since 2000 for all education levels, but most sharply for the lowest-skilled.**
  - **The income premium earned by college graduates continues to increase, but only because non-college incomes are falling more rapidly.**
- **Across racial and ethnic groups**
  - **Median incomes of whites and Asians have remained about twice those of blacks and Hispanics for several decades.**
  - **Asians have the highest mean incomes of any group.**

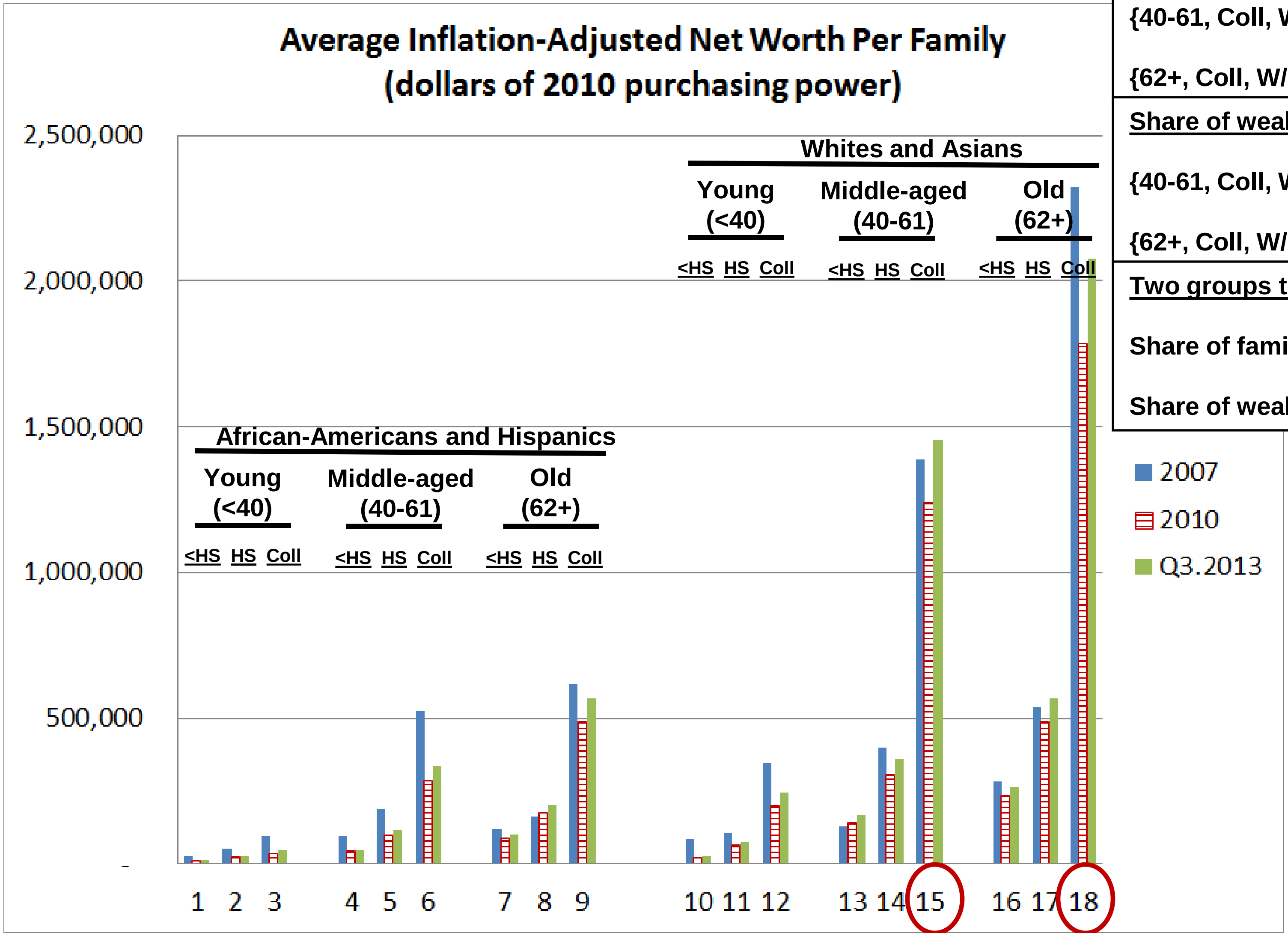
Our Framework: Investigate Demographic Dimensions of Household Balance Sheets

- **Age of family head**
  - **Young: Under 40**
  - **Middle-aged: Between 40 and 61**
  - **Old: 62 or more**
- **Race or ethnicity of family head**
  - **White or Asian**
  - **African-American or Hispanic of any race**
- **Educational attainment of family head**
  - **Less than high-school diploma**
  - **High-school diploma or GED**
  - **2- or 4-year college degree or more**

Result: 18 distinct demographically defined groups

2/3 of Wealth Held by 24% of Families: 40+ Whites/Asians with College Degrees

2010 CPI-U-RS adjusted dollars



Share of families in 2013

{40-61, Coll, W/A}: 15.4%

{62+, Coll, W/A}: 8.3%

Share of wealth in 2013

{40-61, Coll, W/A}: 37.9%

{62+, Coll, W/A}: 29.2%

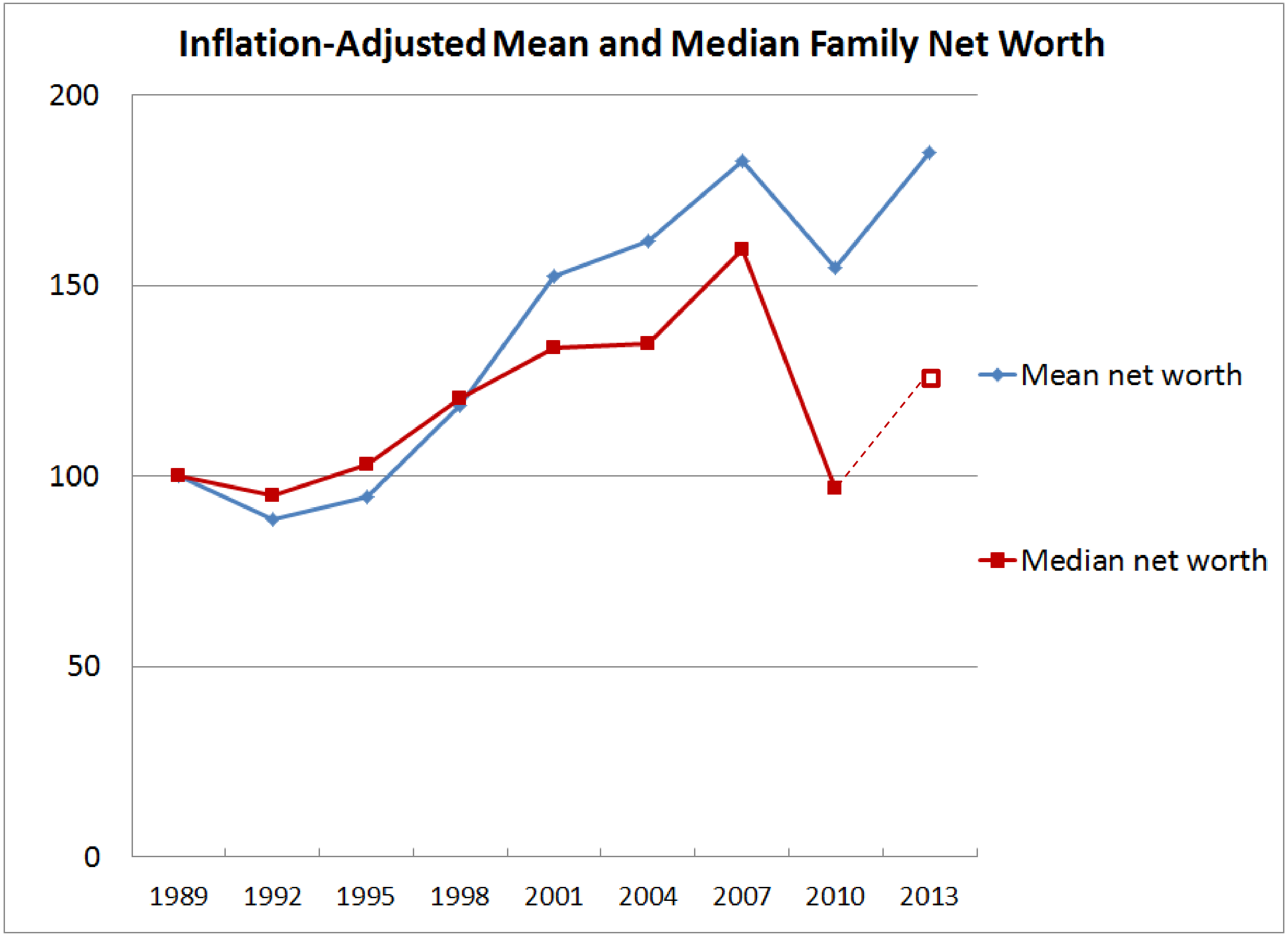
Two groups together

Share of families: 23.7%

Share of wealth: 67.0%

In Contrast to Income and Median Wealth, Mean Wealth Is At All-Time High

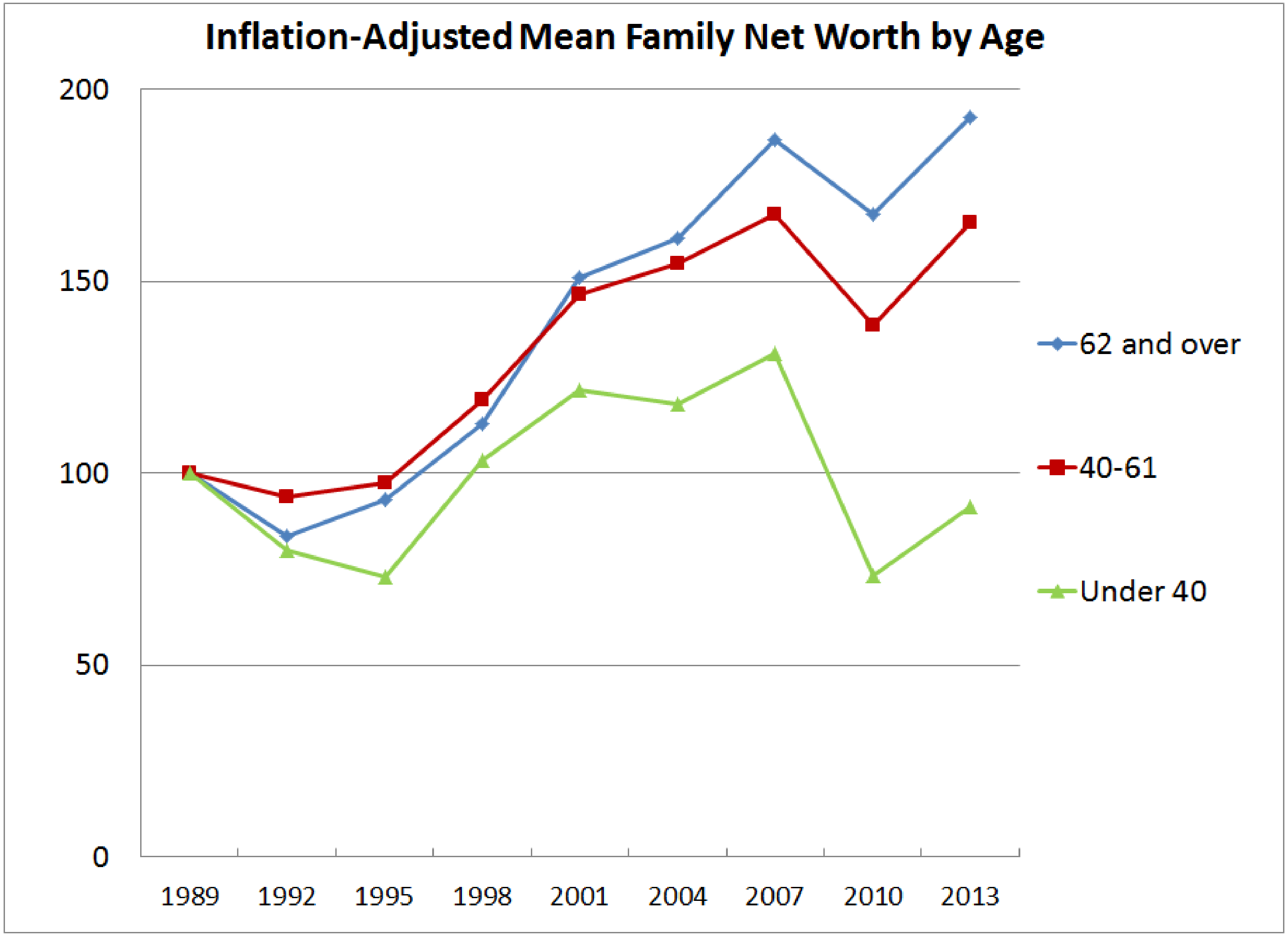
Index levels equal 100 in 1989



Sources: Fed. Res. Board and Fed. Res. Bank of St. Louis; Means: Triennial through 2013; medians: through 2010

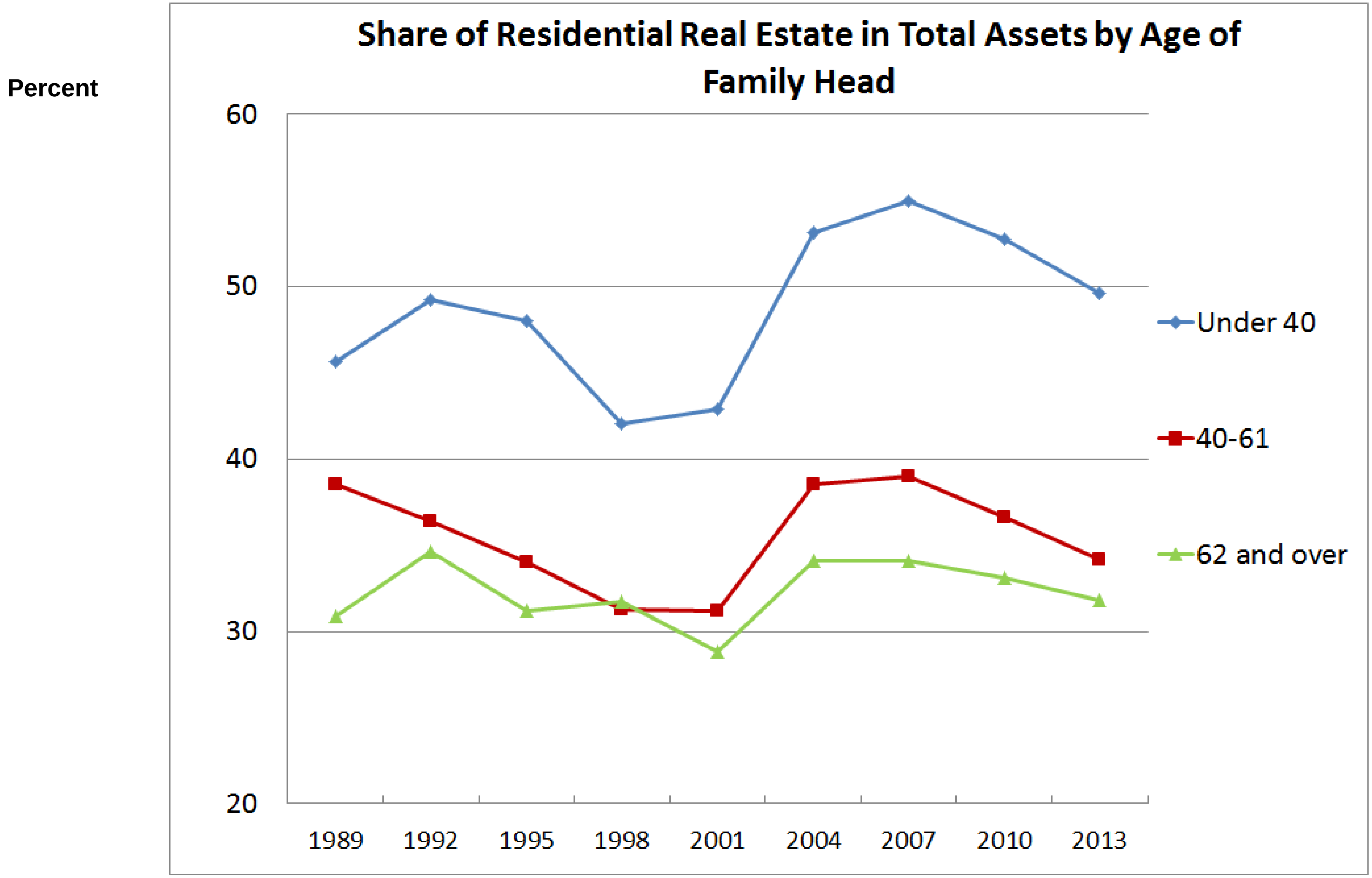
Mean Wealth of Young Families Plunged During Recession; Recovering Slowly

Index levels equal 100 in 1989



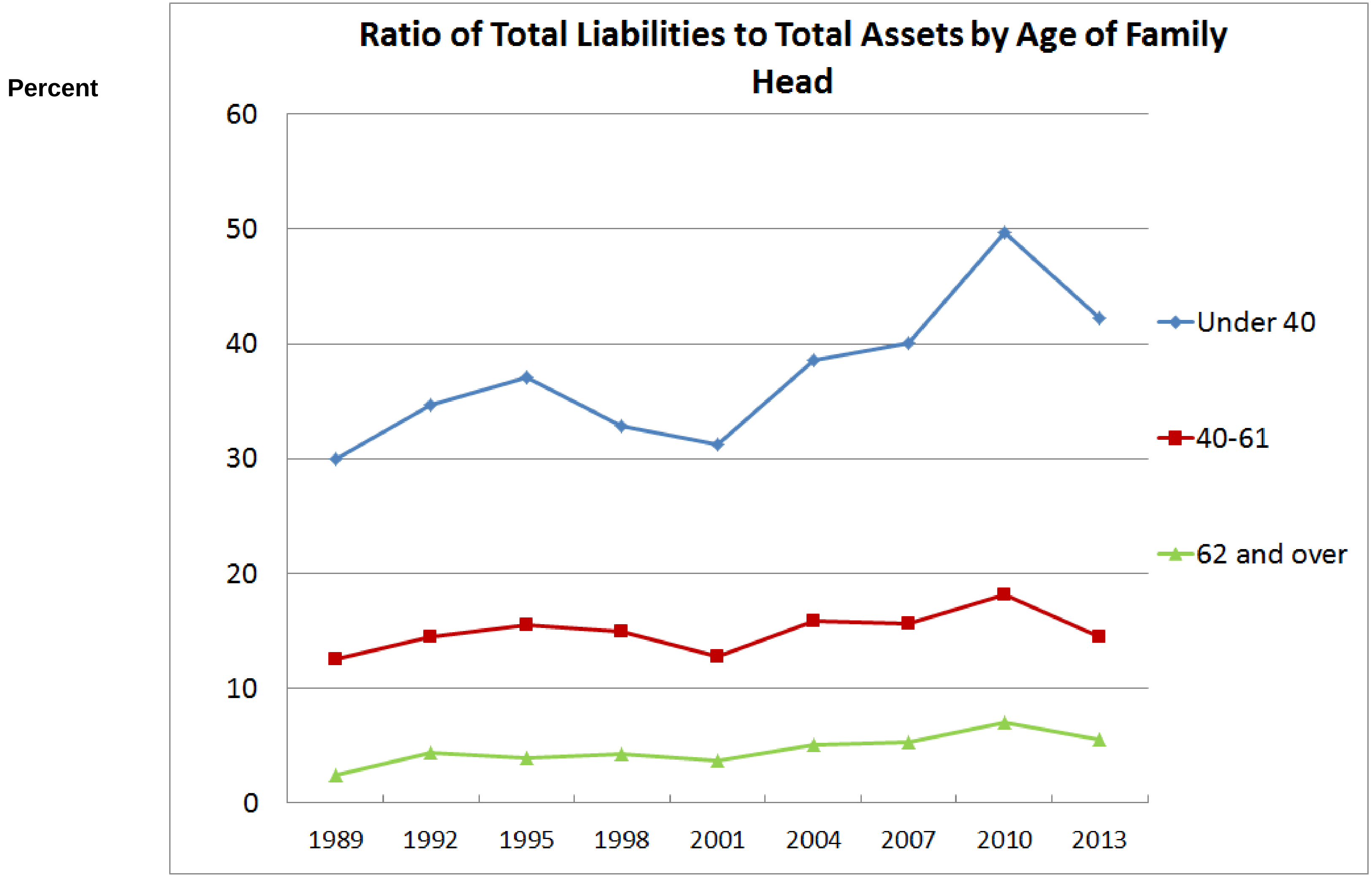
Sources: Fed. Res. Board and Fed. Res. Bank of St. Louis; Triennial through 2013

Why Young and Middle-Aged Families Lost So Much Wealth: Too Much Housing



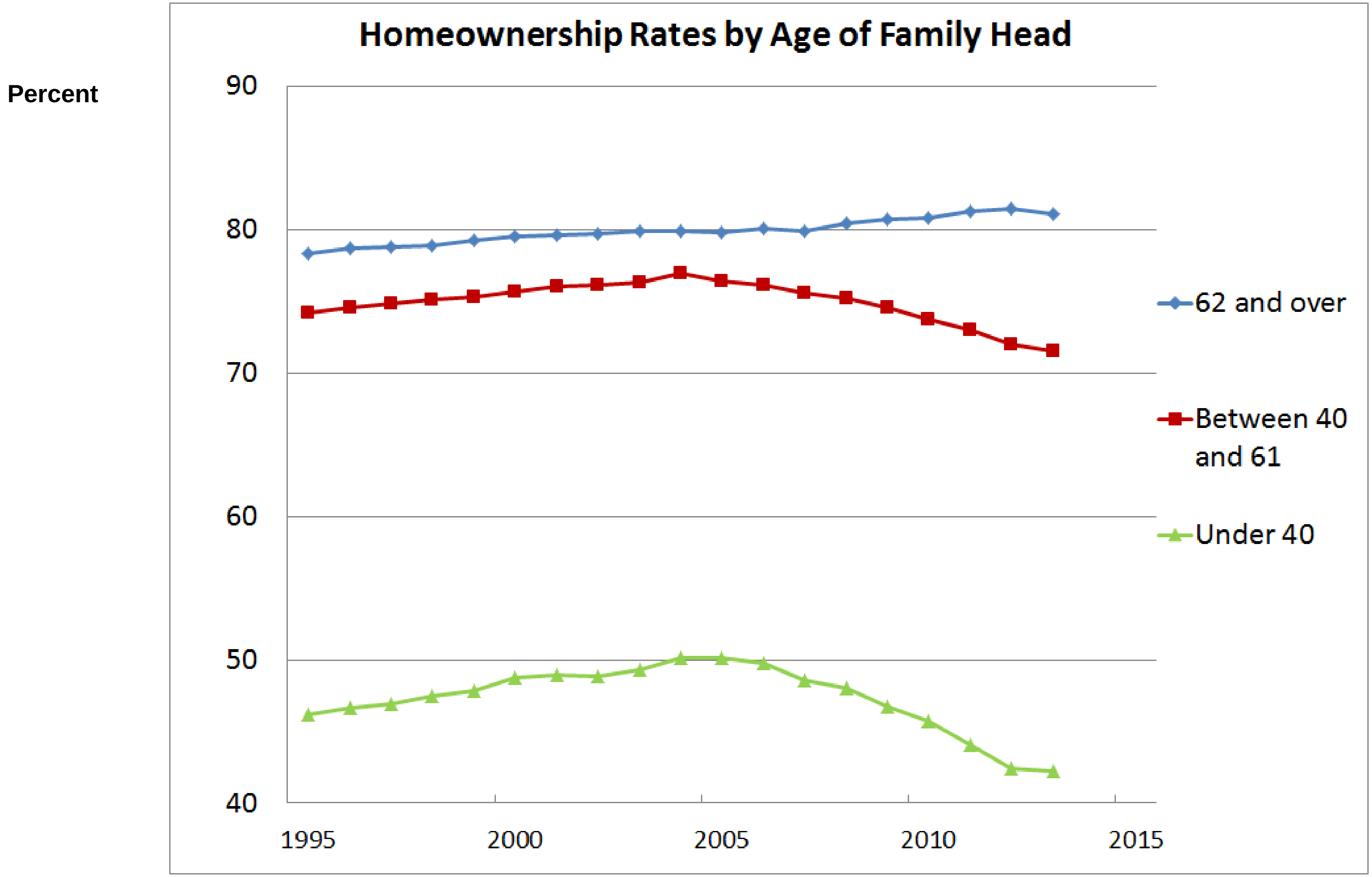
Sources: Fed. Res. Board and Fed. Res. Bank of St. Louis; Triennial through 2013

Why Young and Middle-Aged Families Lost So Much Wealth: Too Much Debt



Sources: Fed. Res. Board and Fed. Res. Bank of St. Louis; Triennial through 2013

Result: Homeownership Rates Are Plunging Among the Non-Elderly

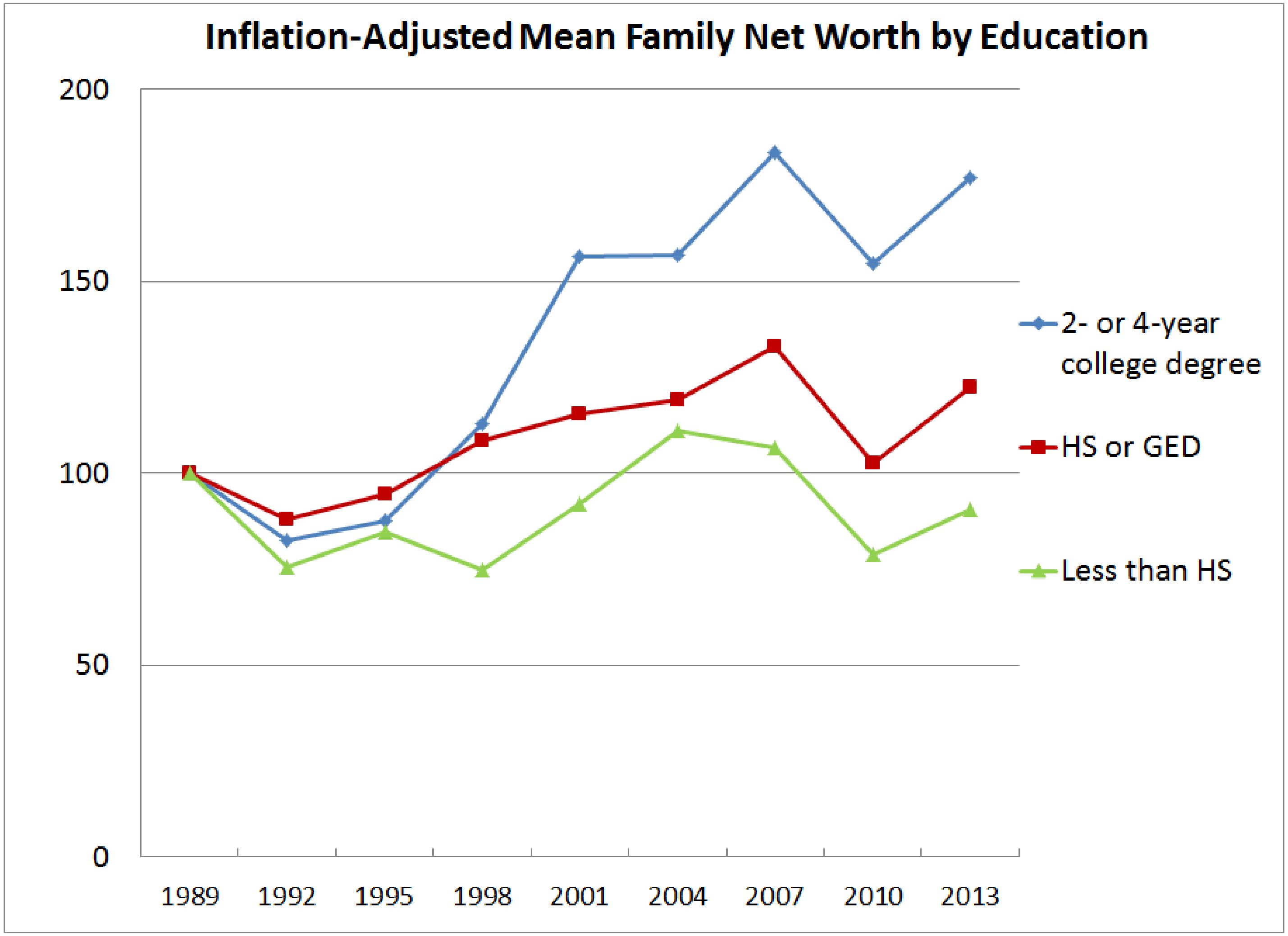


Source: Census Bureau

Annual through 2013

Wealth Inequality Across Education Levels Has Increased Sharply

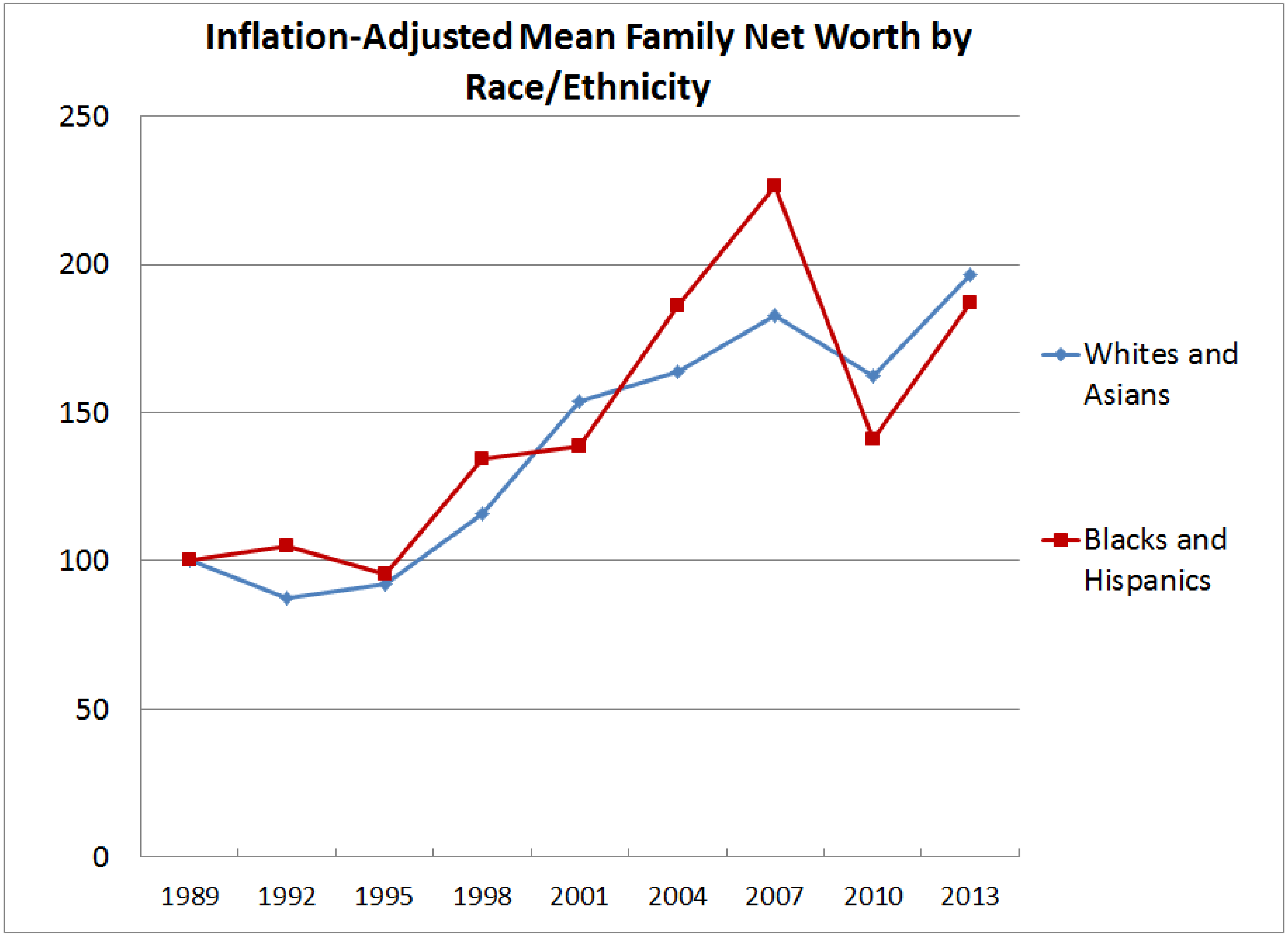
Index levels equal 100 in 1989



Sources: Fed. Res. Board and Fed. Res. Bank of St. Louis; Triennial through 2013

The Racial/Ethnic Wealth Gap of 5X Has Remained Constant in Proportional Terms

Index levels equal 100 in 1989



Sources: Fed. Res. Board and Fed. Res. Bank of St. Louis; Triennial through 2013

Conclusions from Household Balance-Sheet Trends

- **For the population as a whole**
  - **In contrast to income, mean wealth is at an all-time high.**
  - **Median wealth trends are more similar to income trends—middle-income and middle-wealth stagnation.**
  - **Wealth inequality is much greater than income inequality across all dimensions and increased after the recession.**

Conclusions from Household Balance-Sheet Trends

- **Across age groups**
  - **The wealth of older households (62+) has grown faster over several decades, and withstood the recession better, than that of under-62 families.**
  - **Both mean and median wealth of young families has declined over long and short horizons.**
  - **Proximate causes of recent large wealth losses by young families were: i) too much housing, ii) too much debt.**

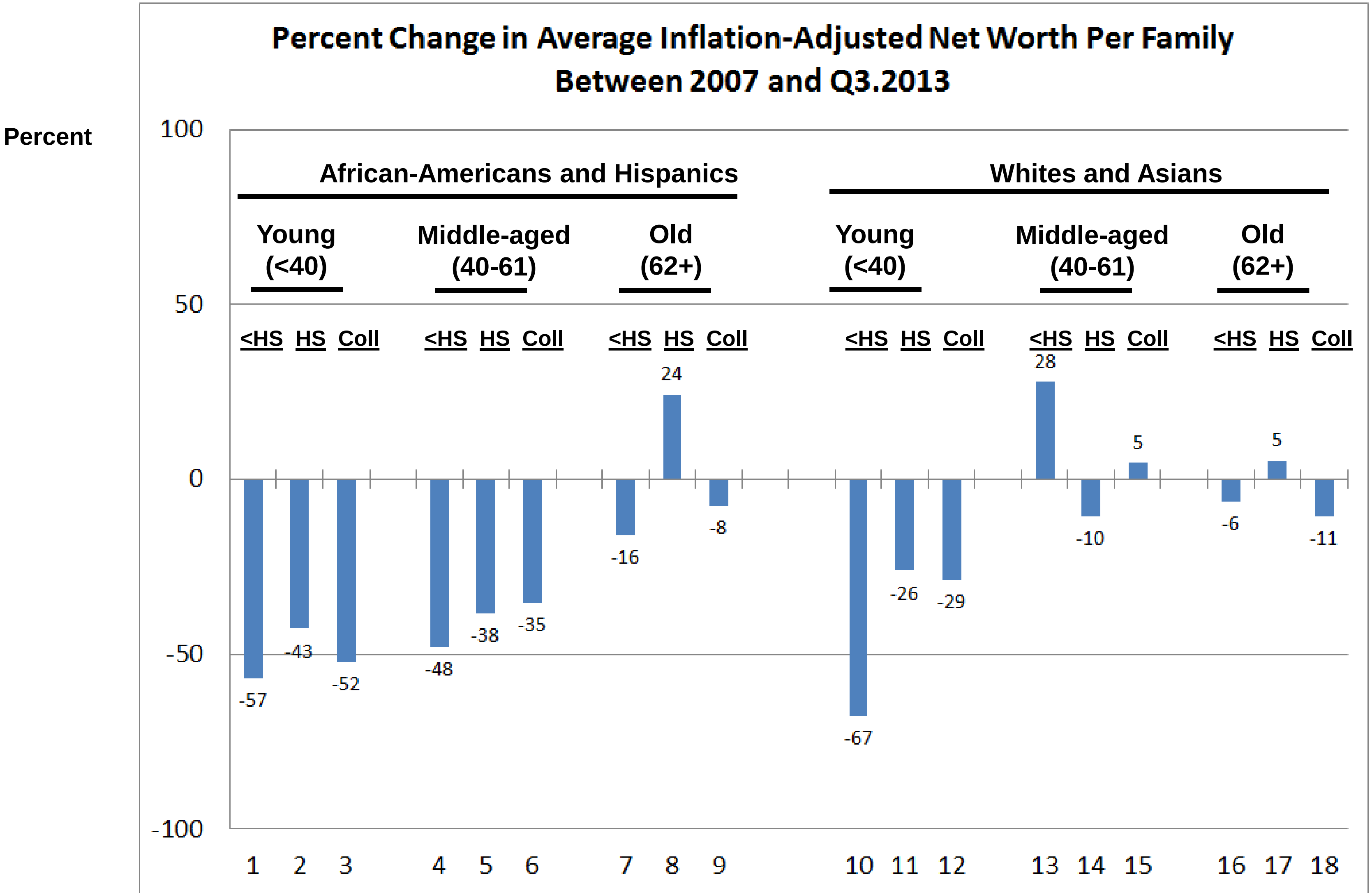
Conclusions from Household Balance-Sheet Trends

- **Across levels of educational attainment**
  - **Virtually all wealth accumulation has been among college-educated families, who own most of the stock market.**
  - **Groups with large housing portfolio shares fared poorly.**
  - **Families with less than high-school education have very little wealth left to lose.**

Conclusions from Household Balance-Sheet Trends

- **Across racial and ethnic groups**
  - **The wealth disparity across racial and ethnic groups remains larger than the corresponding income gap.**
  - **There has been little change in the proportional racial/ethnic wealth gap over time.**
  - **Wealth inequality is increasing *within* racial/ethnic groups, too.**

Who Has Recovered from the Crisis? Older... Better-Educated... Whites/Asians



Why Have Some Groups Done So Much Better Financially than Others?

- **Three underlying factors that link economic vulnerability (high risk of losing a job in a recession) and financial fragility (a risky balance sheet with inadequate diversification, too few liquid assets, too much debt):**
  - **Low cognitive ability.**
  - **Relative youth and inexperience.**
  - **The legacy of discrimination in housing, education, employment, etc.**

The Financial Outlook for American Families

- Real income stagnation (or worse) is likely to continue for most workers due to intense global competition, continuing (marginal) technological advances, and a moderate rate of productivity growth in the U.S.
- Fragile balance sheets continue to make economically vulnerable families more sensitive to recessions.
- Wealth inequality likely to increase because more financially stable families typically hold more liquid assets and more stocks, with smaller roles for housing and debt.

Factors That Could Improve the Outlook for Economically Vulnerable Groups

- **Continued tight credit**
  - **Too much debt contributed to the financial instability of millions of financially fragile families during the recession.**
  - **Less credit access may be a good thing in the long run.**
- **Lower rate of homeownership, especially among vulnerable groups**
  - **For non-wealthy families, buying a house leads to an illiquid, undiversified, over-leveraged balance sheet with a low expected return on wealth.**
  - **Financial assets are better for insuring against income shocks and to build wealth.**

Reasons for Optimism About the Financial Future of Young Americans

- **Generations X (1965-80) and Y (1981-2000)**
  - **Smaller cohorts than the Baby Boomers (1946-64)**
  - **Likely to enjoy more favorable supply-demand conditions over their lifetimes in labor and housing markets.**
- **Young people today can learn from our mistakes**
  - **Invest more in education and training—the college wage premium continues to increase.**
  - **Avoid the risky balance sheets that brought down millions of Americans during the last few years.**

To Learn More About the Financial Outlook for Young American Families

- **Upcoming public events:**
  - **May 8-9, 2014: 2nd Annual Household Financial Stability Research Symposium, at the St. Louis Fed.**
    - **Topic: The Balance Sheets of Younger Americans—Is the American Dream at Risk?**
    - **Sessions on student loans, homeownership, economic mobility, economic impacts of young families, and more.**
  - **October 16-17, 2014: Policy Symposium in Washington DC.**
    - **Topic: The Financial Stability of Younger Americans.**
    - **In partnership with the *New America Foundation* and the *Young Invincibles* (an advocacy group for young Americans).**
- **Find our research, public presentations, and media coverage at www.stlouisfed.org/hfs.**